UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re	No. 97-46121 T No. 97-46123 T
TRANS-ACTION COMMERCIAL INVESTORS, LTD.,and TRANS-ACTION COMMERCIAL MORTGAGE INVESTORS, LTD.	Chapter 11 (Consolidated for Administration)
Reorganized Debtors. _____/	

MEMORANDUM OF DECISION RE MOTION FOR SUMMARY JUDGMENT

Trans-Action Financial Corporation ("TAFC") asserted a secured claim against certain real property and its sale proceeds (the "TAFC Claim").[1] Dolores Staudenraus ("Staudenraus"), a limited partner of Trans-Action Commercial Mortgage Investors, Ltd. ("TACMI"), one of the above-captioned reorganized debtors, and Susan Uecker, the TACMI plan trustee, (the "Trustee") filed objections to the TAFC Claim.

TAFC moved for summary judgment, contending that the objections had no merit as a matter of law, that there was no genuine issue of material fact with respect to the objections and that the objections should be overruled as a matter of law without an evidentiary hearing. The Trustee and Staudenraus opposed the motion. The Court

[1]Although the above-captioned debtors are liable for the TAFC Claim, the real property securing the claim was never property of their bankruptcy estates, having been transferred to other entities prior to the commencement of the bankruptcy cases.

heard oral argument on the motion on May 24, 2002. The Court's findings and conclusions are set forth below.

SUMMARY OF FACTS AND PROCEDURAL HISTORY

Trans-Action Commercial Investors, Ltd. ("TACI") and TACMI are limited partnerships. TAFC is one of several general partners of both TACI and TACMI and was and still is their managing general partner. TACI and TACMI were formed in 1985 for the purpose of acquiring certain real property.[2] One of the properties they acquired, commonly known as the Berkeley Center, secured the TAFC Claim.

In 1985 or 1986, TACMI acquired the real property underlying the Berkeley Center, and TACI acquired the improvements thereon. In 1986, TACI entered into a lease of the underlying property with TACMI (the "TACI Lease"), agreeing to pay TACMI $41,000 per month. TACMI also loaned money to TACI. TACI's obligation to repay the loan was evidenced by a promissory note (the "TACMI Note") which was secured by a deed of trust (the "TACMI Deed of Trust") against the Berkeley Center. The TACMI Deed of Trust was duly recorded at or about the time of its execution.

In 1986, $478,000 of the purchase price for the Berkeley Center was released to the seller, Moshe Eli Cukierman ("Cukierman"). Cukierman transmitted the funds to Robert Bisno ("Bisno"), one of the shareholder's of TAFC, who used them for his own personal benefit.

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[2]Investors in TACI were primarily interested in receiving tax benefits and did in fact receive those benefits. Investors in TACMI expected cash flow from their investment and, to some extent, have not received what they expected.

In 1987, TAFC replaced its own $185,440 debt obligation to TACMI with a debt obligation in the same amount payable by TACI.

TACI and TACMI were unable to pay their operating expenses and debt service. Consequently, TAFC was forced to advance funds to permit them to do so. In 1991, TAFC caused TACI and TACMI to execute a promissory note (the "TAFC Note"), evidencing their obligation to repay these advances. The TAFC Note was secured by a deed of trust on the Berkeley Center (the "TAFC Deed of Trust"). The TAFC Deed of Trust was recorded in March 1992. At the same time, TAFC caused TACMI to subordinate the TACMI Deed of Trust to the TAFC Deed of Trust.

Thereafter, the income from the operation of the Berkeley Center continued to be insufficient to pay its operating expenses and secured debt service. Some of these payments were made with additional advances from TAFC which in turn increased TACI's and TACMI's obligations to TAFC under the TAFC Note. Additionally, in 1992, TAFC caused the TACI Lease to be amended to reduce the monthly rent payment to $25,000 and to make payment contingent on the sale of the Berkeley Center for a sufficient sum to permit all secured debt to be paid.[3]

In 1992, TAFC also caused TACMI to borrow $2 million from TAFC. A portion of the loan proceeds were used to pay amounts due from TACMI to TAFC. In 1996, the TACI Lease was amended again to fix the rent at a percentage of the mortgage payment: i.e., roughly $10,000

[3]This amendment essentially made the TACI Lease obligation to TACMI nonrecourse as to TACMI's general partners: e.g., TAFC.

per month. Payment of this amount was also contingent on the conditions recited above.

When Cukierman purchased the Berkeley Center, he also purchased a lease (the "Arnold Lease") of the Shattuck Hotel, which formed a part of the Berkeley Center. He gave the former owner, Sam Arnold ("Arnold"), a security interest in the Arnold Lease to secure the purchase price. When Cukierman sold the Berkeley Center to TACI and TACMI, he executed with them a new lease of the Shattuck Hotel (the "Cukierman Lease"). Cukierman subsequently filed his own bankruptcy case, and the Cukierman Lease was ultimately rejected. At about the same time, Arnold was granted relief from the automatic stay in Cukierman's bankruptcy case to foreclose on his security interest in the Arnold Lease.

TAFC decided not to attend the foreclosure sale or to attempt to bid on the Arnold Lease. A hotel employee, Jerry Sulliger ("Sulliger"), purchased the Arnold Lease for approximately $45,000. Thus, the Shattuck Hotel was encumbered by the Arnold Lease for the remainder of its term. This encumbrance substantially depressed the sale price for the Shattuck Hotel. The Shattuck Hotel was not sold until after the term of the Arnold Lease expired.

In 1995, TAFC refinanced the secured debt on the Berkeley Center. According to TAFC, at the request of the new lender, TAFC caused TACI and TACMI to transfer the land and improvements to newly formed limited partnerships. (These newly formed limited partnerships will be referred to hereinafter as "BICO" and "BLCO.") TACI was the sole limited partner of BICO; TACMI was the sole limited

partner of BLCO. TAFC was the sole general partner of both new limited partnerships. In 1996, Staudenraus filed a putative class action in state court on behalf of all of the limited partners of TACMI, asserting claims of fraud, breach of contract, and breach of fiduciary duty, among other things, against TAFC and others.

On June 25, 1997, TACI and TACMI filed voluntary petitions seeking relief under chapter 11 of the Bankruptcy Code. The cases were consolidated for administrative purposes. On or about August 21, 1997, the Court extended the protections of the automatic stay to the Berkeley Center on the condition that TAFC agree not to further encumber it other than in the ordinary course of business. TAFC consented to this condition.

For a time, TACI and TACMI operated as debtors-in-possession in the chapter 11 cases. However, on or about April 8, 1998, Susan Uecker was appointed as trustee for TACMI, and David Bradlow was appointed as trustee for TACI. On June 16, 1999, the Shattuck Hotel was sold. TAFC's and TACMI's liens attached to the sale proceeds. The remainder of the Berkeley Center has not been sold, and TAFC's and TACMI's liens remain attached to it.

On January 29, 2001, a reorganization plan (the "Plan") was confirmed. The Plan provided that the claims and interests of the limited partners were unimpaired, including the claims asserted by Staudenraus in the state court action. The TAFC Claim was also unimpaired except that TAFC agreed to subordinate its claim to the claims of the noninsider unsecured creditors. The latter claims have now been paid in full.

Staudenraus objected to confirmation. As a means of resolving this objection, a procedure was incorporated into the confirmation order, giving the Trustee until May 15, 2001 and Staudenraus until May 31, 2001 to file objections to the TAFC Claim.[4] On May 15, 2001, Uecker filed an objection to the TAFC Claim. Uecker filed an amended objection on May 24, 2001.[5] Staudenraus filed an objection to the TAFC Claim on May 31, 2001.

DISCUSSION

A. STANDARDS FOR SUMMARY JUDGMENT AND ALLOWANCE OF PROOFS OF CLAIM

A motion for summary judgment should be granted when the Court determines that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106 S.Ct. 2548 (1986). The moving party must make a prima facie showing that summary judgment is appropriate. Celotex, 477 U.S. at 322. The burden of coming forward with sufficient evidence to overcome this prima facie case shifts to the party opposing the motion. Id. at 324. Alternatively, if the Court is unable to determine the entire

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[4]TAFC filed the TAFC Claim on October 27, 1997. At the time of the bankruptcy petition, the balance due on the TAFC Claim was approximately $4.6 million. At present, TAFC asserts that the balance due is approximately $9.3 million, the increase being due primarily to additional post-petition advances by TAFC.

[5]TAFC requests that the Trustee's amended objection, filed on May 24, 2001, be disregarded because it was filed after the deadline applicable to the Trustee. The Court sees no point in granting this request at this time. The Trustee's amended objection added only one new ground. This ground was included in Staudenraus's timely objection. TAFC may renew its request if Staudenraus settles or withdraws this objection to the TAFC Claim.

claim by summary judgment, the Court may summarily adjudicate any portion of the claim as to which there is not genuine factual issue. Fed.R.Civ.P. 56(d).[6]

A properly executed and filed proof of claim constitutes prima facie evidence of the validity and priority of the claim. Fed.R.Bankr.P. 3001(f). A party objecting to the claim must come forward with sufficient evidence to overcome this prima facie case. If this is done, generally, the claimant has the burden of proving its claim. In re Holm, 931 F.2d 620, 623 (9th Cir. 1991); In re Consolidated Pioneer Mortgage, 178 B.R. 222, 226 (9th Cir. BAP 1995), aff'd 91 F.3d 151 (9th Cir. 1996).

A party objecting to a proof of claim may assert any affirmative defense to the claim that could have been raised by the debtor in the absence of a bankruptcy case. 11 U.S.C. § 558. Setoff constitutes an affirmative defense. In re Charter Co., 86 B.R. 280, 282 (BC MD FL 1988). The party asserting an affirmative defense has the burden of proof on the defense. Fox v. Citicorp Credit Services, Inc., 15 F.3d 1507, 1514 (9th Cir. 1994).

B. SUMMARY OF OBJECTIONS AND ISSUES RAISED BY SUMMARY JUDGMENT MOTION

1. Objections

The Trustee's and Staudenraus' objections to the TAFC Claim are virtually identical. Therefore, for convenience, they will frequently be referred to as if they were a single objection (the

[6]Fed.R.Civ.P. 56 is made applicable to proceedings and contested matters in bankruptcy cases pursuant to Fed.R.Bankr.P. 7056.

"Objection"), and the Trustee and Staudenraus will frequently be referred to collectively as the "Objectors." The Objection asserted the following grounds for disallowing or reducing the TAFC Claim.

First, the Objectors contended that no interest should be allowed on the TAFC Note.[7]

Second, the Objectors contended that the amount due on the TAFC Note should be reduced by setting off the following claims (the "Setoff Claims"):

A. A claim for damages based on TAFC's substitution of a $185,000 note from TACI for a note for the same amount payable by TAFC;

B. A claim for damages based on the transfer to Bisno, via Cukierman, of $485,000 of the purchase price for the Berkeley Center;

C. A claim for damages based on the unpaid rent under the TACI Lease, for which the Objectors contended that TAFC was liable as TACI's general partner;

D. A claim for damages based on TAFC's failure to purchase the Arnold Lease at the foreclosure sale;

E. A claim for damages based on TAFC's advances to TACMI for the purpose of paying TAFC.[8]

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[7]Three grounds were asserted for the denial of interest. One need not be discussed. It was initially contended that interest on the TAFC Note should be limited to TAFC's cost of funds. This contention has now been abandoned.

[8]In addition, the Trustee asserted a right to set off against the TAFC Claim any interest, costs, or attorneys' fees attributable to the claims asserted as setoffs, as recited above. The Trustee also asked that the lien securing the TAFC Claim be transferred to the TACMI bankruptcy estate.

2. Issues Raised by Summary Judgment Motion

TAFC sought summary judgment against TACMI on four distinct grounds.

First, TAFC sought a summary judgment determination that it is entitled to interest on the TAFC Note.

Second, TAFC sought a summary judgment determination that some or all of the Setoff Claims could not be used to eliminate or reduce the balance due under the TAFC Note.

Third, TAFC sought a summary judgment determination that, to the extent some or all of the Setoff Claims could otherwise be used to eliminate or reduce the balance due under the TAFC Note, TAFC was entitled to be indemnified or reimbursed by TACMI for the amount of the reduction.

Fourth, TAFC contended that there was no genuine issue of material fact and that it was entitled to summary judgment on the merits of two of the Setoff Claims.

Each of these issues will be addressed below.[9]

C. DISCUSSION

1. TAFC's Right to Interest on the TAFC Note

TAFC contended that it is entitled to interest on its principal balance under the TAFC Note. TAFC observed that the TAFC Note provided for interest under certain circumstances. It contended that those circumstances were satisfied here. TAFC noted that the Plan

[9]TAFC's motion for summary judgment does not address the merits of the Trustee's claims with respect to the $185,000 debt "swap," the $485,000 payment to Bisno, or the post-petition advances by TAFC to TACMI to permit TACMI to pay TAFC.

did not impair the TAFC Claim. The only substantive objection made by the Objectors was that the circumstances under which the TAFC Note provided for interest were not satisfied here.

Paragraph 3 of the TAFC Note, in pertinent part, states as follows:

> If all of the requirements of this Paragraph 3 are satisfied, Makers [TACI and TACMI] shall pay to Holder [TAFC], solely out of the funds available to either of them from the sale, exchange, conveyance or refinance of all or any portion of the Lease, the Property, or of any other real or personal property described in the Deed of Trust, interest on the Principal Indebtedness at the rate of ten percent (10%) per annum, compounded annually ("Contingent Interest"), from the date that any advance hereunder is outstanding until paid. Contingent Interest shall only be payable by Makers if and to the extent that funds are available to either of them from the sale, exchange, conveyance or refinance of all or any portion of the Lease, the Property, or any other real or personal property described in the Deed of Trust...For purposes of determining whether (and to what extent) funds are available to Makers (or either of them) from a sale, exchange, conveyance or refinance of all or any portion of the Lease, the Property, or of any other real or personal property described in the Deed of Trust, there shall be subtracted from the proceeds of any such sale, exchange, conveyance or refinance each of the following items: (a) any fees, commissions, prorations, transfer taxes or other closing costs which are payable by or chargeable to either of Makers in connection with such sale, exchange, conveyance or refinance, and (b) any indebtedness of Makers, or either of them (including, without limitation, the Principal Indebtedness hereunder) which is secured by the Lease, the Property or by any other real or personal property described in the Deed of Trust.

Thus, the TAFC Note provides that TAFC will receive interest at the rate of ten percent per year if and to the extent there are net

proceeds from the sale or refinance of the Berkeley Center. However, net proceeds are defined as those proceeds after deduction of the costs of the sale or refinance and the payment of any other debt owed by either TACI or TACMI.

TAFC construed this provision to give it the right to interest as long as all of TACMI's secured debt had been paid. The Objectors construed it to give TAFC the right to interest from TACMI (or TACI) only if both TACI's and TACMI's secured debt had been satisfied. TAFC appeared to concede that TACI's debt to TACMI is secured and has not and will not be paid. Therefore, the Objectors contended, TAFC is not entitled to interest.

The Court is inclined to read the provision in question as the Objectors do. A literal reading of the TAFC Note supports the Objectors' position. Moreover, it does not seem inequitable to construe the provision in this fashion since the TAFC Note made TACMI liable to TAFC for advances made for TACI's benefit and vice versa.

At best, the provision is ambiguous. As such, the principle that the ambiguities should be interpreted against the drafter would probably require the Court to adopt the Objectors' view. Maryland Casualty Co. v. Knight, 96 F.3d 1284, 1291 (9th Cir. 1996). However, at present, since the only motion pending is TAFC's, the Court will simply deny TAFC's request for summary judgment on this issue.[10]

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[10]If the Berkeley Center were property of these bankruptcy estates, the outcome on this issue would be different. Regardless of whether the TAFC Note provided for interest under these circumstances, as long as the value of the Berkeley Center exceeded the amount of TAFC's secured claim, TAFC would be entitled to interest. See U.S. v. Ron Pair Enterprises, 489 U.S. 235, 239-249,

2. Objectors' Right to Reduce TAFC Note Balance by Amount of Setoff Claims

TAFC advanced three arguments, not going to the merits of the claims, for denial of the Objectors' right to assert the Setoff Claims to reduce the balance due on the TAFC Note. First, TAFC contended that the claims could not be set off because their limitations periods had expired before the TAFC Note matured. At a minimum, it contended that the claims could only be set off against advances made by TAFC before the limitations period expired.[11] Second, TAFC contended that setoff should be denied on equitable grounds. Third, TAFC contended that the Setoff Claims could not be set off against the TAFC Note because the obligations were not mutual: i.e., the Setoff Claims were asserted against TAFC in its capacity as a fiduciary; whereas, the TAFC Note was due to TAFC in a nonfiduciary capacity.

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109 S.Ct. 1026, 1029-1034 (1989); Rake v. Wade, 508 U.S. 464, 475, 113 S.Ct. 2187, 2193 (1993). However, as noted above, the Berkeley Center was transferred to BICO and BLCO long before the bankruptcy cases were filed.

[11]In response, the Objectors contended that TAFC had no right to include as part of the balance due any advances made under the TAFC Note after the bankruptcy cases were filed. According to the Objectors, even if the post-petition advances were made in the ordinary course of business and thus qualified as administrative expenses, TAFC lost the right to claim them as such by failing to make a timely request for payment. This contention has no merit. In attempting to assert a secured claim that includes post-petition advances against the Berkeley Center and its sale proceeds, TAFC is not attempting to obtain payment of an administrative expense claim. As noted earlier, the Berkeley Center is not and never has been property of these bankruptcy estates.

TAFC's second and third arguments may be disposed of fairly quickly.

Equity

Setoff may be denied on equitable grounds. See Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47, 51 (N.D. Cal. 1982). However, the Court agrees with the Trustee that, to deny setoff, the Court needs to understand all of the underlying facts and circumstances of the case. The summary judgment process does not normally provide a basis for such an understanding. While the Crocker National Bank court declined to permit the setoff of certain vigorously disputed claims, the Court concludes that it would make no sense to do so here. Setoff will only be permitted if the Setoff Claims are determined to be valid. If they are determined to be valid, the fact that they were vigorously contested will be irrelevant.

Mutuality

The Court also finds without merit TAFC's contention that setoff is not permissible because the parties lack mutuality.[12] One of the basic requirements for setoff is that the claims to be set off are by the same parties standing in the same capacity. Newbery Corp. v. Fireman's Fund Ins. Co., 95 F.3d 1392, 1399 (9th Cir. 1996). This principle is illustrated by the two following examples: First, A may not set off a claim against B against a debt owed to C. Second,

[12]TAFC raised this argument for the first time in its reply. The Trustee contented herself with pointing out its lack of merit orally at the hearing and declined the Court's offer to file a surreply.

A may not set off a claim against B against a debt owed to B as the trustee or fiduciary of C. In the latter example, the claims are only nominally held by the same parties. The real parties in interest are the same as in the first example.

However, TAFC contends that there is another aspect to this principle: i.e., that a claim against a fiduciary for breach of its fiduciary duty may not be set off against the fiduciary's personal claim against the claimant. It cites four cases in support of this contention. Although language in some or all of these cases can be read to support this contention, the facts of the cases demonstrate that that reading would be improper.

In the first case cited, for example--Prudential Reinsurance Co. v. Superior Court, 3 Cal. 4th 1118 (1992)--the court stated, as a general proposition, that debts owed in a fiduciary capacity are not subject to setoff. Prudential, 3 Cal. 4th at 1127. However, Prudential merely stands for the proposition that the appointment of an insolvency liquidator for one of the parties, an insolvent insurance company, did not destroy the mutuality of claims by and against the insolvent insurance company. Prudential, 3 Cal. 4th at 1136-1137.[13]

The following language appears in Western Dealer Management, Inc. v. England, 473 F.2d 262 (9th Cir. 1973) and seems to support TAFC's contention:

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[13]In any event, the Court questions whether a debt for breach of a fiduciary duty is owed in a fiduciary capacity. Although it was incurred while acting in a fiduciary capacity, it would seem to be owed by the fiduciary personally.

> 'In general where the liability of one claiming a set-off arises from a fiduciary duty or is in the nature of a trust, the requisite mutuality of debts and credits does not exist, and such persons may not set-off a debt owing from the bankruptcy against such liability.' [Citations omitted.] The rationale of this rule is simply that the liability arising from a fiduciary duty is entirely independent of the debt owing from the bankrupt. The trust res is not owing to the bankrupt's estate but rather is owned by it. [Citation omitted.]

473 F.2d at 265. However, the facts of Western Dealer demonstrate that the liability of the fiduciary referred to the preceding passage is not for breach of one's fiduciary duty. In that case, a parent corporation was attempting to apply money held as a fiduciary for its subsidiary to the parent's claim against the subsidiary. It was in this context that the Western Dealer held that mutuality was lacking. 473 F.2d at 264.

In In re Westchester Structures, Inc., 181 B.R. 730 (Bankr. S.D.N.Y. 1995), the issue presented was whether a general contractor who held funds in trust under New York law for the benefit of a subcontractor could set off its obligation to pay those funds to the subcontractor against a claim against the subcontractor. The general contractor acknowledged that, normally, lack of mutuality would prevent it from doing so. However, it made the interesting argument that, here, it should be permitted to do so because the subcontractor similarly held funds in trust in connection with a separate work of improvement. Westchester, 181 B.R. at 741.

Finally, in In re Luz International, 219 B.R. 837 (Bankr. 9th Cir. 1998), any discussion of the mutuality issue is clearly dicta,

given its finding that there was no evidence in the record establishing whether or not there was a fiduciary relationship. Luz, 219 B.R. at 848.[14] In sum, the Court concludes that there is no lack of mutuality under these circumstances.

Limitations Period

The principal argument raised by TAFC for denial of the Objectors' right of setoff is TAFC's contention that the Setoff Claims may not be set off against the TAFC note because their limitations periods expired before the TAFC Note matured. In support of this contention, TAFC cited § 431.70 of the California Code of Civil Procedure ("CCP"). Section 431.70 provides, in pertinent part, as follows:

> Where cross-demands for money have existed between persons at any point in time when neither demand was barred by the statute of limitations, and an action is thereafter commenced by one such person, the other person may assert in the answer the defense of payment in [sic] the two demands are compensated so far as they equal each other, notwithstanding that an independent action asserting the person's claim would at the time of filing the answer be

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[14]Notably, however, in its brief discussion of this issue, the Luz court cited Libby v. Hopkins, 104 U.S. 303, 308 (1881). In Libby, a merchant ("Merchant A") loaned money to another merchant ("Merchant B") on a secured basis. Merchant A also sold goods on credit on an unsecured basis to Merchant B. Shortly before Merchant B became insolvent, Merchant B made several payments to Merchant A, directing Merchant A to apply them to the secured loan. Instead, Merchant A attempted to set off the payments against its unsecured claim. The Supreme Court held that the set off was improper because Merchant A took the funds as Merchant B's trustee and was therefore required to apply them as directed or return them. The Court distinguished the typical bank setoff where the bank relationship with the depositor is a debtor-creditor relationship. Libby, 104 U.S. at 308-309.

> barred by the statute of limitations. If the cross-demand would otherwise be barred by the statute of limitations, the relief accorded under this section shall not exceed the value of the relief granted to the other party.

CCP § 431.70 (West 2002). The TAFC Note was not due and payable until June 30, 1998. TAFC contended that, by that time, the statute of limitations had expired as to all of the Setoff Claims. As a result, TAFC contended, CCP § 431.70 provided that the Setoff Claims could not be set off against the TAFC Claim.

The Objectors disputed TAFC's reading of CCP § 431.70. They contended that a claim need not be due and payable before the limitations period expires on the claim to be set off; the claim need merely exist. The TAFC Note clearly existed before its maturity date. In fact, some pre-payments were made on the TAFC Note.[15]

The Objectors' contentions have no merit.[16] They cited no authority for their reading of CCP § 431.70. The use of the phrase "cross-demands" in CCP § 431.70 supports the view that a claim must have been due and payable to be available for set off. Moreover, California case law clearly so holds. See Pavlovich v. Neidhardt, 128 Cal. App. 2d 559, 562 (1954), citing Bagdasarian v. Gragnon, 31 Cal. 2d 744, 763-764 (1948):

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[15]The TAFC Note included a provision permitting pre-payment without penalty.

[16]Because the Court agrees with TAFC's reading of CCP § 431.70, it need not consider TAFC's alternative argument that the Setoff Claims may only be set off against the amount due under the TAFC Note for advances made prior to the expiration of the limitations period.

> Appellant [the seller] complains because the damages are set off against the first payments to become due on the real property note instead of against the last payments. It is clear, however, that the award of damages on the cross-complaint was payable immediately, whereas under the terms of the note appellant had an immediate right only to such payments as had then become due. Although he was entitled to a set-off with respect to the matured payments, he had no right to a set-off as to payments that were not yet due. [Citations omitted.]

The Objectors also contended that federal law creates an independent right of setoff, presumably one that is not limited by this principle. They cited a series of cases in support of this proposition. Osmundsen v. Todd Pacific Shipyard and Travelers Insurance Co., 755 F.2d 730, 733 (9th Cir. 1985); Thomas v. Bennett, 856 F.2d 1165, 1169 (8th Cir. 1988); In re Guardian Trust Co., 260 B.R. 404 (Bankr. S.D. Miss. 2000); United States v. Kearns, 177 F.3d 706, 711 (8th Cir. 1999); In re Dayton Seaside Assocs. #2, LP, 257 B.R. 123, 133 (Bankr. S.D.N.Y. 2000). They noted that a debtor's defenses are preserved for the benefit of the estate pursuant to 11 U.S.C. § 558. Westchester, 181 B.R. at 740; In re Papercraft Corp., 127 B.R. 346, 349-350 (Bankr. W.D. Pa. 1991).

The first series of cases cited by the Objectors are all distinguishable. In most of the cases, federal law governed the dispute.[17] In the instant case, California law clearly governs the dispute.

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[17]The only case cited by the Objectors in which federal law did not govern the dispute was Dayton Seaside. However, in that case, the court applied New York law, not federal law, to determine the availability of setoff. Dayton Seaside, 257 B.R. at 133.

Section 558 of the Bankruptcy Code does preserve the debtor's defenses under state law for the benefit of the estate. However, unless the debtor has a right to a defense under federal law, it only preserves the debtor's defenses under state law. See Westchester, 181 B.R. at 740: "The law to be applied to establish whether setoff is permissible is the law of the state where the relevant facts transpired." See also In re PSA, Inc., 277 B.R. 51, 54 (Bankr. D. Del. 2002).

However, the Objectors are correct that, if the limitations periods on the Setoff Claims had not expired by the time the bankruptcy petition was filed: i.e., on June 25, 1997, those limitations periods would then have been extended by two years pursuant to 11 U.S.C. § 108(a): i.e., to June 25, 1999. By that time, the TAFC Note had become due and payable. Therefore, the Court must determine whether TAFC established as a matter of law that the limitations periods on the Setoff Claims expired by June 25, 1997 or, as the Objectors contended, there is a genuine issue of material fact with respect to this issue.

TAFC's motion focused on four Setoff Claims: (1) the substitution of TACI as the obligor for a $185,000 debt in place of TAFC (the "$185,000 Debt Swap Claim"), (2) the payment by Cukierman to Bisno of $478,000 of the purchase price for the Berkeley Center (the "$478,000 Kickback Claim"), (3) the 1990 amendment of the TACI Lease to reduce the monthly rent and make payment contingent on sale of the Berkeley Center and payment of secured debt (the "1990 Lease Amendment Claim"), and (4) TAFC's failure to attend and bid at the

Arnold Lease foreclosure sale (the "Arnold Lease Foreclosure Sale Claim").

TAFC contended that the limited partners, including Staudenraus, knew or should have known of the facts upon which each of these claims was based shortly after the conduct occurred. Thus, all of the limitations periods on the Setoff Claims expired before June 25, 1997. The principal evidence offered in support of these contentions is the Declaration of Robert Bisno (the "Bisno Declaration") filed in support of the motion for summary judgment.

The conduct upon which the $478,000 Kickback Claim was based took place in 1986. TAFC contended that information concerning that conduct was generally available to the limited partners by 1987. Thus, at the latest, the limitations period on this claim expired by 1991.[18] The Bisno Declaration stated that this transaction was reflected in a "closing book," which the limited partners could have reviewed at TAFC's offices. The "closing book" was not attached as an exhibit to the Bisno Declaration.

The conduct upon which the $185,000 Debt Swap Claim was based took place in 1987. TAFC contended that this transaction was disclosed in the 1987 financial statement sent to the limited partners in early 1988. Thus, at the latest, the limitations period on this claim expired by 1992. This factual contention was also supported by the Bisno Declaration. However, in this instance, a copy of the financial statement (the "1987 Financial Statement") was

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[18]The limitations period on a breach of fiduciary duty claim is four years. CCP § 343.

provided (Exhibit P to the Bisno Declaration). The relevant disclosure was contained in Note B which stated as follows:

> NOTE B - RECEIVABLES FROM RELATED PARTIES
>
> At December 31, 1987, the Partnership had receivables from the General Partner of $325,805. Subsequent to year end the Partnership agreed to a substitution of an affiliate as the debtor for $185,440 of this amount. This agreement has been reflected as of December 31, 1987. Accordingly, receivables from related parties consist of $139,365 due from the General Partner and $364,581, due from an affiliate.

The conduct upon which the 1990 Lease Amendment Claim was based took place in 1990. TAFC contended that information concerning that conduct was provided to the limited partners in 1991. Thus, at the latest, the limitations period on this claim expired by 1995. The Bisno Declaration noted that the limited partners were informed of this transaction in the 1991 financial statement (the "1991 Financial Statement") (Exhibit K to the Bisno Declaration).[19] The relevant disclosure was contained in Note E which stated, in pertinent part, as follows:

> NOTE E - LEASES
>
> TACMI's Properties are leased to TACI. Effective January 1, 1990, the land lease was amended to provide that TACI's obligations to pay rents and 17% interest on unpaid rents became wholly contingent upon funds being

[19]However, included as part of Exhibit K is a transmittal letter dated January 28, 1992. Thus, according to TAFC's theory, the limitations period expired sometime in early 1996, not in 1995.

> available to TACI upon sale of TACI's assets, and after payment of all indebtedness secured by TACI's assets. The lease was further amended effective January 1, 1991, to provide for current payments of $25[,000] per month....

Finally, the conduct upon which the Arnold Lease Foreclosure Sale Claim was based took place in November 1993. TAFC did not comment on when the limited partners knew or should have known about this conduct. If a four year limitations period applies to this claim, the limitations period had not expired by the time the bankruptcy petition was filed. However, if a two or three year limitations period applies, the limitations period had expired by that time. The limitations period for a negligence claim is two years. CCP § 339(1). The limitations period for fraud is three years. CCP § 338(d). Like the limitations period for a breach of fiduciary duty claim, the limitations period for a claim for breach of a written contract is four years. CCP § 337.

The Objectors responded with the contention that Staudenraus and the other limited partners did not know of any of the conduct described above until July 8, 1994 at the earliest. This contention is supported by the Declaration of Dolores Staudenraus (the "Staudenraus Declaration").[20]

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[20]TAFC filed a lengthy objection to the Staudenraus Declaration. The objection is overruled. The only merit the Court found in the objection was to certain statements that could be interpreted as hearsay: e.g., statements that she learned from someone other than Bisno that something had purportedly occurred. Her statement that someone made a communication to her is not hearsay. The communication would only constitute hearsay to the extent offered to prove that the thing had related had actually

Staudenraus stated that she invested in TACMI in 1988 and from that time was listed as a partner and permitted to vote. However, she did not receive any year end financial statements for TACMI until sometime after June 30, 1992. At that time, she received a copy of the audit reports for 1991, enclosed with the second quarterly partnership report. She did receive quarterly reports prior to that time but the quarterly reports contained nothing to put her on notice that TACMI or TACI was experiencing any financial problems.

Consequently, when TAFC informed the limited partners, in November 1992, that TACMI needed additional capital, Staudenraus was surprised and set out to determine why the additional capital was needed. However, she contended, she still had no reason to believe there had been any wrongdoing.

Beginning in early 1993, Staudenraus enlisted the services of the broker through whom she had purchased her limited partnership interests, Linda Cypres ("Cypres"). Correspondence was exchanged between Cypres and Bisno. Staudenraus also retained the services of a bookkeeper. Her bookkeeper reviewed the documents received and found no evidence of improper accounting methods.

In February 1994, Bisno conducted a TACMI partnership meeting for the purpose of soliciting additional capital. However, he still did not explain to her satisfaction why additional capital was needed. In May 1994 and July 1994, Staudenraus received additional

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occurred. The Court will interpret the statements in question as only referring to the fact of the communication and not to its truth.

financial records from TAFC. However, she declared that she still did not see any evidence of wrongdoing. Finally, in July 1994, Cypres moved, leaving her with the names of three persons who might be able to assist her in her investigations in the future. One of the names was that of Cukierman, a former owner of the Berkeley Center.

Staudenraus met with Cukierman on July 8, 1994 and learned, for the first time, about the facts underlying the $475,000 Kickback Claim. At this point, she agreed, she was put on notice of that claim since the solicitation materials had been very clear about the proposed uses of the funds held back from the purchase price. Not until later did she learn about the conduct upon which the $185,000 Debt Swap Claim, the 1990 Lease Amendment Claim, and the Arnold Lease Foreclosure Sale Claim were based. She also did not learn until after July 8, 1994 that, in 1992, TAFC had made TACMI liable for over $1 million in debt owed by TACI to TAFC.

The limitations periods referred to above do not always begin to run when the conduct occurs. For fraud, there is a delayed discovery rule expressly stated in the statute. The limitations period does not begin to run until the wrongdoing is discovered or should have been discovered. See CCP § 338(d); April Enterprises, Inc. v. KTTV, 147 Cal. App. 3d 805, 826-827 (1983); Stalberg v. Western Title Ins. Co., 230 Cal. App. 3d 1223, 1230 (1991).

For claims against a fiduciary, the rule established by the case law is even more liberal. Actual knowledge is required. Eisenbaum v. Western Energy Resources, Inc., 218 Cal.App.3d 314, 325 (1990).

A fiduciary has a duty of loyalty and good faith. As a result, a claimant has no duty of inquiry even if apprised of facts that would ordinarily cause suspicion. Lee v. Escrow Consultants, Inc., 210 Cal. App. 3d 915, 921 (1989); Schneider v. Union Oil Co., 6 Cal. App. 3d 987, 991 (1970). Furthermore, the requirement of actual knowledge applies whenever a claim is asserted against a fiduciary regardless of whether the claim is for breach of fiduciary duty, negligence, or breach of contract. Lee, 210 Cal. App. 3d at 922, citing April Enterprises, Inc. v. KTTV, 147 Cal. App. 3d 805 (1983).

Based on the liberal delayed discovery rule applicable to claims against fiduciaries and based on the evidence presented, the Court is unable to conclude that the limitations on any of the Setoff Claims expired before the bankruptcy petition date. TAFC presented no evidence that Staudenraus or any of the other limited partners actually knew about the $478,000 Kickback Claim at any time prior to July 8, 1994, the date Staudenraus declared she first learned about it from Cukierman. The fact that the transaction may have been reflected in the "closing book" is not sufficient to satisfy the requirement of "actual knowledge" established for such claims.

The note in the 1991 TACMI Financial Statement, disclosing the 1990 amendment of the TACI Lease, was sufficiently clear to have given Staudenraus "actual knowledge" of the 1990 Lease Amendment Claim had she read it. However, TAFC presented no evidence that Staudenraus read the note. Staudenraus declared that, because she had no reason to believe that TAFC was guilty of any wrongdoing until

July 8, 1994, she did not scrutinize the financial statements prior to that date.

With respect to the note in the 1987 Financial Statement, the Court concludes that, even if Staudenraus had read it, the note was not sufficiently clear to have given her "actual knowledge" of the $185,000 Debt Swap Claim. The note did not identify TACI as the substituted affiliate. Finally, TAFC presented no evidence of when Staudenraus obtained actual knowledge of the facts giving rise to the Arnold Lease Foreclosure Claim. The sale took on November 3, 1993. The Staudenraus Declaration stated that she did not learn of the facts underlying this claim until *after* July 4, 1994. However, she did not specify and TAFC failed to establish precisely when she did learn about it. If the Arnold Lease Foreclosure Claim is for negligence, which has a two year limitations period, and if Staudenraus learned about the claim before July 25, 1995, the limitations period would have expired before the TAFC Note came due.

Moreover, it was TAFC's burden to establish this factual matter. Although the Objectors have the burden of production and proof as to the merits of the Setoff Claims, TAFC has the burden of production and proof on any affirmative defenses. The contention that the statute of limitations period ran on the Setoff Claims before the TAFC Note came due is an affirmative defense to the Setoff Claims. See Morton's Market, Inc. v. Gustafson's Dairy, Inc., 198 F.3d 823, 832 (11th Cir. 1999). Consequently, TAFC's request for summary judgment on limitations grounds must be denied as to all four Setoff Claims discussed above.

3. TAFC's Right to Indemnification and Reimbursement

TAFC contended that its rights to indemnification under the TACMI Partnership Agreement cancelled out any Setoff Claims that might be found valid and otherwise available for setoff.[21] In support of this contention, TAFC relied on the Bisno Declaration and on Exhibits A and C thereto. Paragraph 17, pages 28-29, of the TACMI Private Placement Memorandum (the "TACMI PPM") (Exhibit A), stated, in pertinent part, as follows:

> The General Partners are under a fiduciary duty to the Partnership and the Limited Partners may bring legal actions for any breach of that duty. However, provisions in the Limited Partnership Agreement may limit such actions. Under the Limited Partnership Agreement, the General Partners are not liable to the Partnership or to the Limited Partners for, and are entitled to indemnification for, errors in judgment or other acts or omissions made in good faith and not amounting to fraud, gross negligence or willful misconduct....

Paragraph 4.4 of the TACMI Partnership Agreement (Exhibit C) stated as follows:

> The Partnership, its receiver or its trustee, shall indemnify, hold harmless, and pay all judgments and claims against the General Partners, their officers, directors, shareholders, employees, agents, subsidiaries, and assigns arising from any liability, loss or damage incurred by them by reason of any act

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[21]TAFC also contended that its right of reimbursement for out-of-pocket expenses incurred in connection with the operation of TACMI's business cancelled out any liability it might otherwise have for the Setoff Claims. See TACMI Partnership Agreement, paras. 7.6 and 8.1. The Court finds the TAFC's right of reimbursement under the TACMI Partnership Agreement inapplicable to the claims asserted here. It would strain the language of these paragraphs beyond reason to read them as applying to litigation between a general partner and the partnership.

> performed or omitted to be performed by them in connection with the Partnership's business, including costs and attorneys' fees and any amounts expended in the settlement of any claims of liability, loss or damage unless the loss, liability or damage was caused by the gross negligence, fraud or criminal act of the indemnified person.

The substance of this paragraph was also contained in the TACMI PPM, at pages 76-77.

TAFC noted that the Objectors did not appear to contend that its conduct constituted gross negligence, fraud, or criminal conduct. Rather, the Objectors appeared to contend that TAFC's conduct constituted a breach of fiduciary duty. TAFC appears to view a breach of fiduciary duty as comparable to ordinary negligence. TAFC cited authority for the proposition that a party can be indemnified for losses incurred as the result of its own negligence, including active negligence: i.e., action rather than just inaction. In support of its contentions, TAFC cited Gribaldo, Jacobs, Jones and Associates v. Agrippina Versicherunges A.G., 3 Cal. 3d 434, 442 (1970); Ralph M. Parsons Co. v. Combustion Equipment Associates, Inc., 172 Cal. App. 3d 211, 220-221 (1985); Morton Thiokol, Inc. v. Metal Building Alteration Co., 193 Cal. App. 3d 1025, 1028-1029 (1987).[22]

In response, the Objectors contended that paragraph 4.4 of the TACMI Partnership should not be construed to apply to derivative

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[22]Notably, none of the cases cited by TAFC involved an attempt to obtain indemnification for a claim asserted by the indemnitor. In all three cases, the indemnitee sought indemnification for claims asserted againgst it by third parties.

claims asserted on behalf of TACMI by TACMI's limited partners (as opposed to claims asserted by third parties). They contended that the limited partners would not have understood paragraph 4.4 to apply to such claims. Absent an express provision to this effect, the Objectors contended, a court would not infer such an intent. In support of this proposition, they cited Southern California Gas Co. v. Ventura Pipe Line Construction Co., 150 Cal. App. 2d 253 (1957). The Southern California Gas court noted, pursuant to California Civil Code ("CC") § 1648, a contract provision would not be read broadly to apply to a subject beyond its apparent application. 150 Cal. App. 2d at 258.[23]

Second, the Objectors contended that TAFC's conduct constituted constructive fraud and thus was expressly excluded from the coverage of paragraph 4.4.[24] In support of this proposition, they cited Stokes v. Henson, 217 Cal. App. 3d 187, 197-198 (1990) (noting that the elements of a "cause of action for constructive fraud are: (1)

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[23]Similarly, in one of the cases cited by TAFC, Ralph M. Parsons, 172 Cal. App. 3d at 227, the court stated that: "If an indemnitor is to be made responsible for the negligent acts of an indemnitee or others over whose conduct it has no control, the language imposing such responsibility should do so expressly and unequivocally so that the contracting party is advised in definite terms of the liability to which it is exposed."

[24]Moreover, even if paragraph 4.4 had proposed to cover breach of fiduciary duty claims, the Objectors contended, such a provision would have been unenforceable. As stated in BT-1 v. Equitable Life Assurance, 75 Cal. App. 4th 1406, 1410, 1412 (1999), "the fiduciary duties of [a general partner to a limited partner] loyalty and good faith cannot be waived....[A] limited partnership agreement cannot relieve the general partner of its fiduciary duties in matters fundamentally related to the partnership business."

fiduciary relationship; (2) nondisclosure (breach of fiduciary duty); (3) intent to deceive, and (4) reliance and resulting injury (causation)"); and Salahutdin v. Valley of California, Inc., 24 Cal. App. 4th 555, 562 (1994)(describing constructive fraud as "a unique species of fraud applicable only to a fiduciary or confidential relationship."))[25]

Third, the Objectors contended the Setoff Claims were beyond the scope of paragraph 4.4 of the TACMI Partnership Agreement because, in doing the acts upon which the claims were based, TAFC was acting in its own interests rather than in furtherance of the partnership business. By analogy, they contended that, in a corporate context, to be indemnified, the fiduciary must have been performing a corporate function. See Cal.Corp.Code § 317; Plate v. Sun-Diamond Growers, 225 Cal. App. 3d 1115, 1123 (1990). In Plate, the court stated that: "Where personal motives, not the corporate good, are predominant in a transaction giving rise to an action, indemnification is not warranted." 225 Cal. App. 3d at 1123.

Finally, the Objectors contended that, even if paragraph 4.4 were construed to require TACMI to indemnify TAFC for the Setoff Claims, the provision should be invalidated as against public policy. In support of this proposition, the Objectors cited CC § 1668 (contract is against public policy if its purpose is to exempt person

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[25]The Salahutdin court also stated that "there is no clear line establishing when a fiduciary's breach of the duty of care will be merely negligent and when it may be characterized as constructive fraud. However, a breach of a fiduciary duty *usually* constitutes constructive fraud." 24 Cal. App. 4th at 563.

from responsibility for his own fraud); Blankenheim v. E.F. Hutton & Co., 217 Cal. App. 3d 1463, 1471 (1990); Cohen v. Kite Hill Community Assn., 142 Cal. App. 3d 642, 654 (1983). As stated in Cohen, "[t]his public policy applies with added force when the exculpatory provision purports to immunize persons charged with a fiduciary duty from the consequences of betraying their trusts." Cohen, 142 Cal. App. 3d at 654.

In reply, TAFC took issue with each of the Objectors' contentions. It contended that paragraph 4.4 was unambiguous and clearly applied to the Setoff Claims. It contended that none of the acts upon which the Setoff Claims were based could be fairly characterized as gross negligence, fraud, or criminal conduct. Therefore, the indemnification provision was consistent with the policy expressed in CC § 1668. Moreover, except perhaps for the $478,000 Kickback Claim, the Objectors did not contend that TAFC received some personal benefit; thus, TAFC's conduct was clearly in furtherance of the partnership business. TAFC contended that it did not receive any benefit as a result of its conduct in connection with the 1990 Lease Amendment Claim because the TACI Lease was never intended to be with recourse to TAFC.

The Court concludes that TAFC is not entitled to be indemnified in an amount equal to the amount of any reduction in the TAFC Note balance as a result of the Setoff Claims. A reasonable person would not have read paragraph 4.4 of the TACMI Partnership Agreement to require TACMI to reimburse TAFC for any claims successfully asserted by TACMI against TAFC. The only sensible reading of paragraph 4.4 is

as applying only to claims asserted against TAFC by third persons.[26]

With respect to whether the Setoff Claims are properly characterized as claims for constructive fraud or ordinary negligence, the Court is persuaded by the footnoted language in Salahutdin that the answer to this question depends on the facts of the case. It is possible that a breach of fiduciary duty claim may qualify as ordinary negligence although, most often, it will constitute constructive fraud. Under these circumstances, based on the evidence presented, the Court is unwilling to impose a characterization on the Setoff Claims in a summary judgment context.

Finally, to the extent that the Setoff Claims constituted constructive fraud, as opposed to ordinary negligence, the Court concludes that it would violate public policy to require TACMI to indemnify TAFC for them. CC § 1668; BT-1 v. Equitable Life Assurance, 75 Cal. App. 4th 1406, 1412 (1999): "[A] limited partnership agreement cannot relieve the general partner of its fiduciary duties in matters fundamentally related to the partnership business. [Citations omitted.]"[27]

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[26]The TACMI PPM did state with sufficient clarity that TAFC would not be liable to TACMI on grounds of negligence as long as its conduct were in good faith. If such a provision had been included in the TACMI Partnership Agreement, TAFC would clearly have been protected from such claims. However, no such provision was included. Paragraph 4.4 cannot be called upon to fill this gap.

[27]Whether TAFC was acting in furtherance of the partnership business in connection with the Setoff Claims is a closer question, as least as to some of the claims. Given the Court's conclusion that the indemnification provision does not apply to the Setoff Claims for several other reasons, the Court declines to address

4. Merits of 1990 Lease Amendment Claim and Arnold Lease Foreclosure Sale Claim

Finally, TAFC contended that it was entitled to summary judgment on the merits of the 1990 Lease Amendment Claim and the Arnold Lease Foreclosure Sale Claim. TAFC contended that the Objectors had failed to establish that there was a genuine issue of material fact with respect to these claims. These claims and the evidence and argument presented regarding them are discussed below.

a. 1990 Lease Amendment Claim

The Objectors contended that TAFC breached its fiduciary duty to TACMI in 1990, by causing TACMI to agree to an amendment of the TACI Lease, reducing the monthly rent to $25,000 and making the payment of rent contingent on sale of the Berkeley Center and payment of the secured debt.[28] The TACI Lease did not state that it was without recourse to the general partners. Under general partnership law, a general partner is liable for the debts of the partnership. Cal. Corp. Code §§ 15509, 15643 (general partner of limited partnership has same liability as general partner in general partnership); Mariani v. Price Waterhouse, 70 Cal. App. 4th 685, 706 (1999). By causing the TACI Lease to be amended in this fashion, so as to eliminate its liability for any shortfall in the rent, the Objectors

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this final contention.

[28]The TACI Lease was amended two more times after 1990, once in 1992 to reduce the rent to $25,000 per month and a second time in 1996, to fix the rent at a percentage of the mortgage payment. Although the primary focus of this claim has been on the 1990 amendment of the TACI Lease, similar issues are presented by these two subsequent amendments.

contended, TAFC acted in its own interests and contrary to TACMI's interests.

TAFC moved for summary judgment on this claim. TAFC contended that the 1990 amendment of the TACI Lease was not a breach of fiduciary duty for two reasons. First, the TACI Lease was always intended to be nonrecourse. Second, the 1990 amendment was not done to eliminate the general partners' liability for any rent shortfall. It was done in response to a complaint by certain limited partners that, due to the accrual nature of TACI's tax accounting, they were being required to pay income tax on rent they were not receiving: i.e., "phantom income."

In support of these contentions, TAFC offered the Bisno Declaration and two exhibits thereto: a letter from C.E. Patterson (the "Patterson letter") to Bisno (Exhibit F) and a declaration by Michael J. McQuiller (the "McQuiller Declaration") dated February 12, 2001 (Exhibit H). Patterson was the broker who solicited investments in TACMI. He is also the manager of an investment fund which owns or controls the majority of the limited partnership interests in TACMI at this time. McQuiller was the attorney who advised TACI and TACMI beginning in 1985 concerning the income tax consequences to limited partners of an investment in the partnerships.

The Bisno Declaration paralleled the contentions recited above.[29] The Patterson letter, which is dated October 16, 2000, stated, in pertinent part, as follows:

> It is my belief, and has always been my belief, that the lease and loan obligations, from TACI in favor of TACMI, are and have always been recourse only to the properties owned by TACI. There has never been any hint of recourse liability beyond TACI's properties.
>
> Obviously, had TAFC or the other general partners any recourse liability, this fact would have been material, would have been represented to investors, and, in fact, when my affiliate purchased, during the last two or three years, limited partnership interest from TACMI limited partners wishing to sell same, I would have been duty-bound to disclose to them that the TACI obligation (lease or loan) was recourse.[30]

Moreover, Patterson noted, this statement was contrary to his own financial interest.

Paragraphs 7-9 of the McQuiller Declaration stated, in pertinent part, as follows:

> Sometime after the execution of the Ground Lease and the issuance of the TACI Note, TACI was unable for various reasons to make payments due to TACMI under the Ground Lease and the TACI Note....

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[29]The Bisno Declaration also noted that the amendment had been disclosed in the 1991 Financial Statement and that no limited partners had objected until the present litigation. The Objectors contended that the disclosure was inadequate. The Court concludes that whether the disclosure was or was not adequate is irrelevant since the Objectors do not appear to be basing the 1990 Lease Amendment Claim on TAFC's failure to make adequate disclosure of the amendment.

[30]This point is not persuasive since the 1990 amendment to the TACI Lease eliminated the general partners' liability in any event.

> [S]ince TACMI was an accrual basis taxpayer TACMI's limited partners were forced to recognize significant taxable "phantom income" from the accrued TACI Note and Ground Lease payments.
>
> To correct this situation...TACI and TACMI decided to amend the TACI Note and the Ground Lease to make the payment obligations thereunder wholly contingent upon TACI having sufficient available funds from a sale of the property with which to make such payments. I advised TACMI that these amendments would have the effect of eliminating the "phantom income" problem described above. The Ground Lease was accordingly amended....[31]

The Objectors contended that there were genuine issues of material fact as to whether the TACI Lease was originally intended to be nonrecourse and whether the 1990 amendment of the TACI Lease was done to resolve a tax problem for the limited partners as opposed to eliminate the general partners' liability for the rent shortfall. With respect to the first issue, they contended that the TACI Lease was unambiguous and should be interpreted as written to make the general partners personally liable for any rent shortfall. They characterized the Bisno Declaration as self-serving and unreliable. They contended that the Patterson letter should be disregarded

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[31]The McQuiller Declaration also stated that he had noted in his tax opinion letter, a copy of which was attached to the TACMI PPM, that the promissory note executed by TACI in favor of TACMI (the "TACI Note"), like the TACI Lease, did not expressly state that it was nonrecourse. McQuiller did not explain what led him to the conclusion that the TACI Note was nonrecourse given the absence of any such statement in the note. The McQuiller Declaration further noted that, like the TACI Lease, the TACI Note was amended to make it expressly nonrecourse. However, it did not state when or why this occurred.

because there was no evidence that Patterson was involved in the negotiation or drafting of the TACI Lease.

To the extent the parties' subsequent conduct was to be taken into account, the Objectors contended, the 1990 amendment was evidence that the TACI Lease was originally intended to be with recourse. If not, there would have been no need for the amendment. They contended that essentially TAFC was seeking to "reform" the TACI Lease. The purpose of reformation is to correct a drafting error so that the written document reflects the actual agreement. Getty v. Getty, 187 Cal. App. 3d 1159, 1179-1180 (1986); Power Service Corp. v. Joslin, 175 F.2d 698, 704 (9th Cir. 1949). However, there was no competent evidence that the actual agreement had been that the TACI Lease would be nonrecourse. Therefore, there could be no reformation.

With respect to the second issue, the Objectors challenged TAFC's contention that the TAFC Lease had been amended to resolve the "phantom income" problem. In support of their challenge, they offered the declarations of two tax experts, R. Gordon Baker, (the "Baker Declaration"), a tax attorney, and Martin Litwak (the "Litwak Declaration"), a tax accountant.[32] Baker declared he had been asked to opine on whether it was necessary to place conditions on the

[32]TAFC filed an evidentiary objection to the Litwak Declaration. Based on the Court's understanding of the issues at this time, the Court finds the objections to be without merit and overrules them at this time. However, the objections may be overruled at the time of trial if the Litwak appears as a witness.

payments due under the TACI Lease that resulted in eliminating the general partners' liability for any shortfall.

Baker opined that it was not. He stated that it was only necessary to make the obligation to pay rent contingent on some event to occur in the future, even one that was certain to occur. In this way, the "phantom income" would not have been realized until the future event occurred. However, the general partners would not have been relieved of their personal liability for any shortfall.

Similarly, the Litwak Declaration stated that the "phantom income" problem could have been solved simply by making the obligation to pay rent contingent on a sale of the Berkeley Center. The income would then have been realized only when the sale occurred. The additional requirement that there be sufficient sale proceeds to pay the rent after payment of all secured debt, the condition that made the TACI Lease nonrecourse to the general partners, was not required.

The Objectors also noted that McQuiller did not declare that he recommended the form of the 1990 amendment of the TACI Lease. Rather, he declared that that TACMI and TACI had decided to amend the TACI Lease in this fashion and that he had advised Bisno that it would resolve the limited partners' "phantom income" problem.

In its reply, TAFC contended that the Objectors had failed to meet their burden of establishing that there was a genuine issue of material fact with respect to either aspect of the 1990 Lease Amendment Claim. TAFC contended that the Bisno Declaration and the Patterson letter should not be disregarded as incompetent or

unreliable. They noted that Bisno was a signatory to the TACI Lease and thus was competent to offer parol evidence establishing the intent of the parties in entering into the TACI Lease.

TAFC contended that it was appropriate to consider parol evidence to determine the intent of the parties with respect to the recourse/nonrecourse nature of the TACI Lease. In support of this contention, TAFC cited Southern California Edison Co. v. Superior Court, 37 Cal. App. 4th 839, 848 (1995) and Southern Pacific Transportation Co. v. Santa Fe Pacific Pipelines, Inc., 74 Cal. App. 4th 1232, 1245-1246 (1999). TAFC also contended that the parties' conduct after the contract was executed, before any controversy arose is the most reliable evidence of its intended meaning, citing Kennecott Corp. v. Union Oil Co., 196 Cal. App. 3d 1179, 1189 (1987). Moreover, a contract may be explained by reference to the circumstances under which it was made. CCP § 1860.[33] In response to the Objectors' complaint that there was no evidence that Patterson was involved in the negotiation or preparation of the TACI Lease, TAFC filed a declaration by Patterson (the "Patterson Reply Declaration"). The Patterson Reply Declaration explained that, during the late 1980s, Patterson Financial Services, of which he was a registered representative, provided underwriting services for TACMI and TACI. He was also an initial investor in TACMI through the PPW Profit Sharing Plan, of which he is the primary beneficiary.

[33]TAFC also cited to CC § 1674 in support of this proposition. Its citation appears to be in error. There is currently no such section in existence.

Patterson stated that, when he invested in TACMI, he had no expectation that the TACI Lease would be recourse to the general partners of TACI. He stated that the TACI Lease was not included in the TACMI PPM or solicitation materials, and he did not ask to see a copy of the TACI Lease. He noted that the TACMI PPM stated that the risk of the investment depended on TACI's operating performance.

Patterson also stated that he never represented to anyone that the TACI Lease was recourse nor did he ever provide a copy of the TACI Lease to a prospective TACMI investor. If he had believed the TACI Lease to be with recourse to the general partners, he would have done so, because it would have been an important factor in their decision to invest. Moreover, he would have conducted substantial due diligence as to the ability of the general partners to assume that risk. However, he would have questioned Bisno's sanity if Bisno had agreed recourse liability under the TACI Lease because the "economic structure" of the deal did not justify the assumption of this level of risk.

TAFC also contended that the Objectors had presented no evidence that any TACMI limited partner believed that the TACI Lease was originally with recourse to the general partners. TAFC noted that, prior to the present controversy, no TACMI limited partner ever sought payment of the unpaid rent from TAFC or the other general partners of TACI. Moreover, Staudenraus' conduct at the time she invested clearly indicated that she did not understand the TACI Lease to be a recourse obligation. She requested and received a guaranty from TAFC of the projected TACMI cash flow for 1988 through 1992.

Since the rent from the TACI Lease was the major source of that cash flow, if she had believed that the general partners were liable for any shortfall in the rent, she would not have asked for the guaranty.

Furthermore, TAFC contended, the limited partners would certainly have objected to TAFC's loaning money to TACI and TACMI if they had believed that TAFC was responsible for the TACI Lease payments, because TAFC notified them that its advances would be repaid before any return on the limited partners' investments. In support of this final contention, TAFC relied on the Supplemental Declaration of Robert Bisno (the "Supplemental Bisno Declaration"), filed with the reply.

Finally, TAFC contended that the Objectors had failed to establish a genuine issue of material fact with respect to its contention that the desire to solve the "phantom income" problem was not the sole reason for the 1990 amendment to the TACI Lease. TAFC contended that the Objectors had acknowledged that TAFC had "pursued the amendments upon the advice of expert tax counsel." TAFC characterized as "quibbling" the Objectors' point that TAFC's tax counsel had not actually "recommended" the amendment. TAFC's characterization of the McQuiller Declaration was that McQuiller had stated that he had recommended the amendments for this purpose. TAFC also contended that, because McQuiller never had any reason to believe that the TACI Lease was recourse, he did not consider the effect of the amendment on TAFC's recourse liability in advising on the amendment.

Moreover, TAFC noted that Baker, Staudenraus' tax expert, offered virtually the same solution as McQuiller's to the "phantom income" problem. TAFC noted that all of the suggestions contained a risk of nonpayment, such a risk being a necessary element in any provision designed to avoid payment of tax on "phantom income." TAFC also contended that the statement in the Baker Declaration that the "phantom income" problem could have been solved without eliminating TAFC's personal liability for the TACI Lease obligations differed from his statements in his first declaration and from his deposition testimony.

The Baker Declaration stated that any condition on the payment of rent, even one that is certain to occur in the future, was sufficient to avoid the accrual of "phantom income." TAFC contended that this expert opinion was incorrect. TAFC contended that, to avoid the accrual of "phantom income," there must be an absolute risk of nonpayment. Moreover, TAFC contended that Baker admitted as much in his second deposition. In support of this contention, TAFC cited to paragraph 11 of the Supplemental Declaration of Michael McQuiller filed in support of TAFC's reply (the "Supplemental McQuiller Declaration") and to a portion of a second deposition of Baker, excerpts of which are attached as Exhibit E to the Supplemental McQuiller Declaration.[34]

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[34]In the Supplemental McQuiller Declaration, McQuiller stated that it would not be sufficient to avoid the accrual of "phantom income" if the payment were simply contingent on some event that was certain to occur in the future. The risk of nonpayment must be absolute. However, contrary to TAFC's assertion, Baker did not concede this point in the excerpt from his second deposition.

In determining whether TAFC has established the right to summary judgment on the 1990 Lease Amendment Claim, the first issue to be decided is whether and, if so, for what purpose parol evidence may be considered in construing the meaning of the TACI Lease. If no parol evidence may be considered, the conclusion is foregone. The TACI Lease creates a debt obligation for TACI. As noted by the Objectors, under partnership law, absent some contrary agreement, TAFC and the other general partners of TACI are liable for TACI's debts.

As noted above, TAFC cited three cases in support of its right to present extrinsic evidence to prove that the TACI Lease was always intended and understood to be nonrecourse. Two of these three cases, Southern California Edison Co. v. Superior Court and Kennecott Corp. v. Union Oil Co., are not precisely on point. In Southern California Edison, the appellate court held that extrinsic evidence should be considered in determining whether contract language is ambiguous. 37 Cal. App. 4th at 848. In Kennecott, the court held that extrinsic evidence of conduct should determined in construing ambiguous contract language. 196 Cal. App. 3d 1189. However, the issue presented here is not whether language included in the contract is ambiguous but whether language not included in the contract may be implied based on extrinsic evidence.

Dicta appearing in Souther Pacific Transportation Co. could be considered on point except for one problem. In that case, the court stated as follows: "...courts can rely on usage and custom to imply a term where the contract itself is silent in that regard." 74 Cal. App. 4th at 1241. The difficulty in applying this dicta to the issue

at hand is that it does not appear that the contract in Southern Pacific Transportation Co. contained an integration clause, stating that the contract was intended as a final and complete expression of the parties' agreement. The TACI Lease contains such a clause. See Bisno Declaration, Exhibit E, para. 11.07.

The Court has also considered the relevant provisions of the California Civil Code and California Code of Civil Procedure. Section 1640 of the California Civil Code provides that the intention of the parties, as expressed in a writing, is to be disregarded if it fails to accurately reflect the parties' intention due to fraud, mistake, or accident. The Court reads this provision as sufficiently broad to apply to omitted language as well. Thus, TAFC may present extrinsic evidence to establish that the TACI Lease mistakenly omitted the statement that the rent obligation was to be nonrecourse. Section 1856(e) of the California Code of Civil Procedure contains a similar provision. Moreover, CC § 1856(e) appears to apply even to a contract with an integration clause. See CCP § 1856(b),(e).

Additionally, CCP § 1860 provides that, in construing an instrument, the circumstances under which the instrument was made should be considered. This would appear to apply even to an integrated contract. In sum, the Court concludes that it can consider parol evidence to prove that the failure to include a nonrecourse provision in the TACI Lease was a mistake. Moreover, parol evidence as to custom and usage may be presented for this purpose.

Nevertheless, having considered the parol evidence presented by the parties, the Court concludes that there is a genuine issue of material fact as to each of the two issues underlying the 1990 Lease Amendment Claim. The failure of the TACI Lease to state that it is nonrecourse creates a sufficient factual basis to put the first issue in controversy. While Bisno's declaration is relevant, it is also self-serving and cannot be accepted at face value. The Court feels compelled to hear live testimony on the subject.

Moreover, the Court agrees with the Objectors that what TAFC is seeking is reformation. Thus, TAFC must convince the Court that, when the TACI Lease was executed, it was intended to be nonrecourse and that, by some mistake, this provision was not included in the TACI Lease. It would not be sufficient to prove that, had Bisno thought about it, he would have wanted the TAFC Lease to be nonrecourse. To date, no evidence has been presented as to who prepared the TACI Lease and why, if this was TAFC's intention, the TACI Lease did not include this provision.

Most of the remainder of the evidence offered by TAFC is essentially irrelevant.[35] What Patterson believed the TACI Lease provided is beyond the point since, as he admitted, he never saw the TACI Lease. Patterson failed to explain upon what he based this belief. Patterson declared that, if he had thought the TACI Lease

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[35]The one point the Court did find relevant, although not necessarily decisive, is the fact noted by Patterson that the TACMI PPM stated that the risk of the venture depended on the success of TACI's operations. The location of this comment was not noted. The TACMI PPM was too long for the Court to attempt to locate it without assistance.

was with recourse, he would have advised the investors of that fact because it would have been an important consideration in their decision to invest. However, he failed to explain why, if he considered the recourse nature of the TACI Lease significant, he failed to review a copy of the TACI Lease or apparently even ask Bisno whether the TACI Lease was with or without recourse to the general partners.

At first blush, the fact that Staudenraus insisted on a guaranty by the general partners of the projected cash flow for 1988 through 1992 seems to compel a ruling in favor of TAFC. However, on further reflection, the Court concludes that it is irrelevant. The issue is whether the TACI Lease was intended to be nonrecourse in 1986, when the TACI Lease was executed. Staudenraus was not involved in TACMI at that time. What Staudenraus believed the TACI Lease provided later, when she invested, is simply irrelevant to this issue.

In drafting the TACI Lease, the Court assumes, Bisno was essentially negotiating with himself. Thus, unless there were other parties who have not been identified involved in the drafting process, Bisno's state of mind and contemporaneous expressions of that state of mind will probably be the only relevant evidence. However, the two Bisno Declarations fail to explain how the TACI Lease came to omit a nonrecourse provision. If the recourse nature of the TACI Lease did not occur to Bisno at the time the lease was drafted, the Court will be compelled to construe the TACI Lease as written, to be with recourse. The TACI Lease may not be "reformed" to include a provision that was not intended to be included at the

time the contract was prepared and executed. On the other hand, if Bisno did consciously intend a nonrecourse provision to be included in the TACI Lease, he must provide credible evidence explaining why such a provision was not included.

With respect to the second issue, the Court also believes that it must hear Bisno's live testimony as to his motivation in amending the TACI Lease in 1990. The Court notes that the "limited partners" who complained about "phantom income" are not identified and that Bisno's statement that they complained is probably inadmissible hearsay. Moreover, as noted above, the Court does not read the McQuiller Declaration to say that McQuiller advised TAFC as to how to structure the amendment. The Court also reads the opinions of the tax experts as in conflict as to whether it was necessary to structure the amendment in such a way as to eliminate the general partners' personal liability in order to eliminate the "phantom income" problem.

In sum, the Court concludes that TAFC must be denied summary judgment with respect to the merits of the 1990 TACI Lease Amendment Claim. The Court concludes that parol evidence may be considered to establish the circumstances under which the TACI Lease was executed and that the failure of the TACI Lease to specify that it was nonrecourse was a mistake. The Court believes that the opinions of Litwak and Baker, that it was not necessary to eliminate the general partners' liability for any rent shortfall, are sufficient to create a genuine issue of material fact as to TAFC's motivation for the 1990 amendment.

b. Arnold Lease Foreclosure Sale Claim

The Objectors also contended that TAFC acted negligently and breached its fiduciary duty by failing to purchase the Arnold Lease at the Arnold Lease foreclosure sale. TAFC moved for summary judgment on this claim, contending that it was protected from liability by the business judgment rule. The business judgment rule:

> ...refers to a judicial policy of deference to the business judgment of corporate directors in the exercise of their broad discretion in making corporate decisions. The business judgment rule is premised on the notion that those to whom the management of the corporation has been entrusted, and not the courts, are best able to judge [the wisdom of]...a particular act or transaction...and establishes a presumption that directors' decisions are based on sound business judgment. [Citation omitted.]

Gaillard v. Natomas Co., 208 Cal. App. 3d 1250, 1263 (1989); see also Wyler v. Feuer, 85 Cal. App. 3d 392, 402 (1978)(holding that business judgment rule applies to general partners of limited partnerships).

A threshold issue is whether summary judgment may ever be granted in favor of a defendant based on the business judgment rule. The Objectors contended that, because a defendant's right to immunity under the business judgment rule is a question of fact, summary judgment is never appropriate; live testimony is always required so that witness credibility may be judged. In support of this contention, the Objectors cited FDIC v. Jackson, 133 F.3d 694, 700 (9th Cir. 1998).

The Objectors also contended that all of the cases cited by TAFC in its opening brief in support of its right to summary judgment were decided after a trial on the merits, not in a summary judgment

context: i.e., Wyler v. Feuer, 85 Cal. App. 3d 392, 402 (1978); Moore v. Tristar Oil and Gas Corp., 528 F. Supp. 296, 312 (S.D.N.Y. 1981); and Lee v. Interinsurance Exchange, 50 Cal. App. 4th 694, 715 (1996). In reply, TAFC disagreed. It contended that courts had frequently granted summary judgment in favor of a defendant based on the business judgment defense, citing FDIC v. Castetter, 184 F.3d 1040 (9th Cir. 1999); Barnes v. State Farm Mutual Auto Insurance Co., 16 Cal. App. 4th 365, 378-379 (1993).[36]

Having reviewed the authorities cited above, the Court concludes that TAFC is correct and the Objectors are wrong. Whether the business judgment rule immunizes a general partner from liability for a particular action or inaction in connection with the business of a limited partnership is clearly a question of fact. See FDIC v. Jackson, 133 F.3d at 700 (involving directors of failed bank). Moreover, the Jackson court did state that, under the facts presented there, credibility was at issue, and summary judgment would be inappropriate. FDIC v. Jackson, 133 F.3d at 700. However, the Court does not read this statement to mean that credibility will always be at issue when the business judgment rule is invoked as a defense so that summary judgment will never be appropriate.

Furthermore, the Objectors are incorrect that the cases cited by TAFC in its opening brief were all decided after a trial on the merits rather than in a summary judgment context. In Lee v.

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[36]A third case cited by TAFC in its reply, Ralph C. Wilson Industries, Inc. v. American Broadcasting Companies, Inc., 598 F. Supp. 694 (N.D. Cal. 1984), does not appear to be on point.

Interinsurance Exchange, 50 Cal. App. 4th at 723, the appellate court affirmed the dismissal of plaintiffs' claims after defendants' demurrers were sustained without leave to amend. Similarly, in two of the cases cited in TAFC's reply, the motions were granted without hearing live testimony. In Barnes v. State Farm Mutual Auto Insurance Co., 16 Cal. App. 4th at 369, as in Lee, the appellate court affirmed the dismissal of claims after a demurrer was sustained without leave to amend. In FDIC v. Castetter, 184 F.3d at 1046, the appellate court affirmed an order granting the defendants' motion for summary judgment.

Thus, as with any motion for summary judgment, the Court must decide whether the evidence presented establishes that there is a genuine issue of material fact with respect to the plaintiff's claim. If not, the Court should grant the motion for summary judgment. Moreover, the burden is on the plaintiff to provide sufficient evidence to sustain a finding that some exception to the business judgment rule prevents the defendant from claiming immunity. See Lee v. Interinsurance Exchange, 50 Cal. App. 4th at 715:

> The business judgment rule sets up a *presumption* that directors' decisions are made in good faith and are based upon sound and informed business judgment. (*Barnes*, *supra*, 16 Cal.App.4th at p. 378; *Katz v. Chevron Corp.*, *supra*, 22 Cal.App.4th at pp. 1366-1367.) An exception to this presumption exists in circumstances which inherently raise an inference of conflict of interest. (*Id.* at p. 1367.)")

TAFC correctly noted that the Objectors have presented no evidence that TAFC had a conflict of interest in connection with the Arnold Lease Foreclosure Claim or, for that matter, that it acted in bad

faith or overreached. The sole issue appears to be whether TAFC conducted an adequate investigation before making its business decision not to attend the foreclosure sale and attempt to purchase the Arnold Lease.

In support of its motion for summary judgment on this claim, TAFC cited various reasons for its decision not to attempt to purchase the Arnold Lease at the foreclosure sale. First, for a variety of reasons, TAFC concluded that the Arnold Lease had no economic value and that no one would bid at the sale. Second, TACI and TACMI did not have enough available cash to bid at the sale, and third, their partnership agreements did not authorize them to acquire the lease. If TAFC had had more time, perhaps, the partnership agreements could have been amended, and funds could have been located. However, TAFC only had five days' notice prior to the sale. Given the difficulty in reaching some of the limited partners quickly, this was not sufficient time to do what was needed.

TAFC also contended that it did not have sufficient funds itself to bid at the sale and, in any event, had no obligation to do so. Nevertheless, it noted, Bisno did contact Arnold before the foreclosure sale and attempt to purchase the Arnold Lease for a modest price without success. Moreover, had TAFC's attorney advised Bisno of the potential damages that TACI and TACMI would suffer if someone other than Arnold purchased the Arnold Lease, TAFC would have attended the sale and attempted to purchase the lease. However, there is no guaranty that it would have been successful. Therefore,

according to TAFC, the Objectors could not establish that TAFC's failure to attend the foreclosure sale caused any damage to TACMI.[37]

Although the Court does not accept TAFC's contentions and Bisno's declarations at face value, the Objectors offer little relevant evidence to meet their burden of establishing that TAFC failed to make a reasonable investigation with regard to the practicality and necessity of bidding at the Arnold Lease foreclosure sale. The Objectors did offer (or noted the existence of) evidence sufficient to create a genuine issue of material fact as to whether TACI, TACMI, or TAFC could have raised funds sufficient to overbid Sulliger at the foreclosure sale.

Moreover, the Court is not prepared to conclude as a matter of law, based on the evidence presented by TAFC, that TAFC could not have advanced the funds itself.[38] The Objectors noted that, at a Rule 2004 exam of Sulliger taken in late November 1993, shortly after the foreclosure sale, Sulliger testified that he would not have been able

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[37]In support of its contentions, TAFC relied on the Bisno Declaration and the exhibits thereto: i.e., the TACMI PPM (Exhibit A) and the TACMI Partnership Agreement (Exhibit C). TAFC also relied on the Declaration of Randall I. Barkan (the "Barkan Declaration"), a real estate attorney who opined that TAFC's conduct met the standard of care for general partners of real estate limited partners. The Court will disregard the latter declaration. The Court does not believe that the opinion of an expert is necessary or helpful on this issue. This is not a professional malpractice case.

[38]The principal evidence in support of this contention is Bisno's self-serving declarations.

to bid more than $60,000.[39] TAFC admitted having advanced over $200,000 to TACI and TACMI during the year preceding the sale to keep the two partnerships "afloat." Additionally, since the commencement of the bankruptcy case, TAFC has purportedly advanced approximately $5 million for the same purpose. Given this evidence, at a minimum, there is a genuine issue of fact as to whether TAFC could not have raised sufficient funds to overbid Sulliger even given only five days notice.[40] Bisno's own testimony at his August 19, 1998 deposition (Declaration of Robert Cross, hereinafter the "Cross Declaration", Exhibit A) also supports this conclusion.

However, the Court does not believe that this disputed fact is material. The Court finds the critical issue to be, as contended by TAFC, whether Bisno reasonably relied on his attorney, Ivan Gold's ("Gold"), failure to warn him of the potential consequences of not purchasing the Arnold Lease, either before or at the foreclosure sale.

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[39]This contention is supported by a declaration of Sulliger (the "Sulliger Declaration") executed in support of the Objectors' opposition to TAFC's motion for summary judgment, a copy of which is attached as Exhibit E to the Cross Declaration. TAFC filed evidentiary objections to the Sulliger Declaration. However, given the Court's conclusion that TAFC is entitled to summary judgment on this claim, the objection is moot.

[40]Like TAFC, the Objectors also relied to some extent on the declaration of an "expert," Stephen Mayer ("Mayer" and the "Mayer Declaration"). Mayer, a partner in the Trustee's duly appointed accounting firm, offered the opinion that TAFC could have easily raised the necessary funds if they had tried to do so. The Court will also disregard the Mayer Declaration as unnecessary and unhelpful. Moreover, as with the Sulliger Declaration, given the Court's ruling on the Arnold Lease Foreclosure Claim, Mayer's comments are irrelevant.

The Objectors contended that Gold's testimony at his deposition on March 22, 1999 contradicted Bisno's testimony. However, the Court disagrees. Gold apparently testified that he urged Bisno to attend or send someone to the foreclosure sale with authority to bid on the Arnold Lease. Gold testified that he had previously urged Bisno to attempt to buy the Arnold Lease from Arnold before the foreclosure sale. He also testified that Bisno had called Arnold and attempted to reach an agreement to that effect but that Arnold and Bisno had apparently had a disagreement, and someone hung up. (Cross Declaration, Exhibit C.). However, Gold does not appear to have testified or otherwise declared that he warned Bisno that TACI and TACMI might suffer millions of dollars of damages if someone other than Arnold bought the Arnold Lease.

It appears to be undisputed evidence that Gold failed to warn Bisno that there could be serious consequences if someone other than Arnold purchased the Arnold Lease at the foreclosure sale. In fact, no evidence has been presented that either Gold or Bisno ever contemplated this possibility. No evidence has been presented that their failure to contemplate it was unreasonable. Given this failure and the undisputed evidence that Bisno reasonably believed that no one else would bid at the sale, the Court concludes that there is no genuine issue of material fact with respect to this Setoff Claim and that TAFC is entitled to judgment in its favor on it as a matter of law.

CONCLUSION

The Court denies TAFC's request for summary judgment, determining that it is entitled to interest on the principal balance of the TAFC Note. The TAFC Note appears to permit the payment of interest only if all the secured claims of both TACI and TACMI have been paid. It appears that not all the secured debt of TACMI has been paid.

The Court denies TAFC's request for summary judgment, preventing the assertion of the Setoff Claims to reduce or eliminate the balance due on the TAFC Note for reasons unrelated to the merits of the claims. First, although setoff may be denied for equitable reasons, the Court must hear all the facts before determining the equities. Second, the obligation under the TAFC Note and the Setoff Claims are mutual. They are owed by the same parties in the same capacity.

Third, in order for the Setoff Claims to be used as setoffs for the TAFC Note obligation, their limitations periods may not have expired before the bankruptcy petition date. However, because the Setoff Claims are asserted against TAFC as a fiduciary, the limitations periods did not begin to run until Staudenraus obtained actual knowledge of the conduct upon which the claims are based. TAFC has failed to present sufficient evidence to establish that Staudenraus obtained actual knowledge of any of the Setoff Claims sufficiently early that its limitations period expired before the bankruptcy petition date.

Next, the Court denies TAFC's request for summary judgment, determining that it is entitled to indemnification and reimbursement

by TACMI to the extent that any of the Setoff Claims are deemed valid and available as setoffs to the TAFC Note balance. The reimbursement provisions of the TACMI Partnership Agreement have no application to claims established against TAFC. The indemnification provisions are most reasonably read as applying only to claims by third parties. Moreover, the Setoff Claims may constitute claims for constructive fraud and thus would be excluded from indemnification by both the contractual language and public policy.

The Court also denies TAFC's request for summary judgment with respect to the 1990 Lease Amendment Claim. There is a genuine issue of material fact as to whether the TACI Lease was originally intended to be nonrecourse and as to the purpose for the 1990 Amendment.

Finally, the Court grants TAFC's request for summary judgment with respect to the Arnold Lease Foreclosure Claim. Although there are genuine issues of fact with respect to whether TAFC could have raised the funds to overbid Sulliger at the foreclosure sale, no evidence has been presented that TAFC had any reason to believe that anyone other than Arnold would purchase the lease or that, if anyone else did, the consequences of such a purchase would be seriously damaging to TACMI.

The Objectors are directed to submit a proposed form of order in accordance with this decision.

Dated: June 28, 2002

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United States Bankruptcy Judge

PROOF OF SERVICE

I, the undersigned, a regularly appointed and qualified clerk in the office of the United States Bankruptcy Court for the Northern District of California at Oakland, hereby certify:

That I, in the performance of my duties as such clerk, served a copy of the foregoing document by depositing it in the regular United States mail at Oakland, California, on the date shown below, in a sealed envelope bearing the lawful frank of the Bankruptcy Court, addressed as listed below.

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

Dated: June ___, 2002

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